Decision 03-11-015 November 13, 2003

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In re Application of WORLDCOM, INC. Pursuant to Public Utilities Code Section 853(b) for Exemption from the Requirements of Sections 851 and 854 of the Public Utilities Code With Respect to its Bankruptcy Reorganizations.	Application 03-08-016 (Filed August 20, 2003)

OPINION GRANTING EXEMPTION FROM REQUIREMENTS OF PUBLIC UTILITIES CODE SECTIONS 851 and 854

Summary

This decision grants the application of WorldCom, Inc. (WorldCom) for an order pursuant to Pub. Util. Code § 853(b)[1] exempting the restructuring and certain related intra-corporate transactions undertaken to consummate WorldCom's Plan of Reorganization under Chapter 11 of the Federal Bankruptcy Code from prior Commission approval under §§ 851 and 854.

Background

1. The Parties

WorldCom, Inc. is a long-distance carrier currently in bankruptcy proceedings.[2] It has filed a Plan of Reorganization (Plan) in the Bankruptcy Court for the Southern District of New York seeking to emerge from bankruptcy

[1] All statutory references are to the Public Utilities Code, unless otherwise noted.

protection under Chapter 11 of the United States Bankruptcy Code.[3] It seeks a decision from this Commission finding that § 853(b) exempts WorldCom from the requirement that we approve the restructuring and related intra-corporate transactions required to implement the Plan.

WorldCom does not agree that the Commission has jurisdiction over this matter, and states that it has filed this application with the Commission out of respect for the Commission and in order to provide the Commission with full information about the post-emergence structure of WorldCom's California public utility subsidiaries, and to avoid litigation over the extent of the Commission's jurisdiction.

The Greenlining Institute and the Latino Issues Forum (Greenlining) filed an "initial response" indicating that it was conducting discovery "that [would] enable [WorldCom] to demonstrate . . . how it will become a responsible corporate citizen." Greenlining did not protest the application and has presented us with no argument against approval of the application.

The Commission's Office of Ratepayer Advocates (ORA) filed a response stating that it does not oppose WorldCom's request for an exemption from §§ 851 and 854. It reasons that the proposed Plan will not result in any change to rates or to the terms and conditions of service, and will not disrupt service to customers. By the same token, ORA "vehemently disagrees that the Chapter 11 process substitutes for Commission jurisdiction."

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2 *In re WorldCom, Inc.*, Case No. 02-13533 (AJG) (S.D.N.Y).

3 The Plan and related documents are available online at http://global.mci.com/news/infodesk.

2. WorldCom's Recent History

As detailed in a document entitled "Restoring Trust," which WorldCom filed as a supplement to its application,[4] in recent years certain personnel at WorldCom committed "what appears to be the largest accounting fraud in history."[5] "In WorldCom's saga approximately $200 billion in shareholder value was first created, and then destroyed."[6] The previous board of directors of WorldCom "consistently ceded power over the direction of the Company to [former WorldCom CEO Bernard J.] Ebbers. As CEO, Ebbers was allowed nearly imperial reign over the affairs of the Company, without the board of directors exercising any apparent restraint on his actions. . . ."[7] Mr. Ebbers received lavish compensation and loans in the hundreds of millions of dollars.

Moreover, WorldCom was engaged in a

> massive use of improper accounting practices, such as the capitalization of billions of dollars of normal operating costs . . . result[ing] in reported profits that were overstated enormously. The best current estimates suggest that income was overstated by at least $11 billion over a multiyear period . . . . [T]he phony accounting

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[4] The document is Exhibit A in evidence. *See* Transcript of Prehearing Conference (PHC) dated October 2, 2003 (PHC Transcript), at 10. The document's 78 recommendations for reform of WorldCom were prepared at the direction of the Honorable Jed S. Rakoff of the United States District Court for the Southern District of New York, pursuant to the terms of a Permanent Injunction that Judge Rakoff entered in connection with an enforcement proceeding brought against WorldCom by the Securities and Exchange Commission (SEC). The Injunction is Exhibit B in evidence.

[5] Restoring Trust, Exh. A, at 1.

[6] *Id.* at 12.

[7] *Id.* at 1-2.

> created the false impression that the Company's management was highly successful . . . .[8]

There is, however, reason for hope. As a result of the foregoing activities, the SEC brought suit against WorldCom.[9] On June 11, 2003, District Judge Rakoff entered an order memorializing a partial settlement of the case. In that order, WorldCom agreed to be bound by recommendations in the soon-to-be-issued "Restoring Trust" document:

> [A]bsent further Order of the Court, WorldCom shall adopt and implement each of the recommendations that will be made by the Corporate Monitor in his report with respect to corporate governance.[10] In the event WorldCom determines that adopting and implementing any particular recommendation made by the Corporate Monitor[11] would be too costly, or would be otherwise inappropriate, unreasonable or unnecessary, WorldCom may move the Court for entry of an Order providing that it need not adopt and implement such recommendation. Any such motion by WorldCom shall be made, on notice to the [SEC], within 60 days of the receipt of the report of the Corporate Monitor.

Thus, WorldCom shall be bound by the recommendations in the "Restoring Trust" report unless, within 60 days of receiving the document, it files a motion seeking to be relieved from any provision of the report. In a letter submitted in this proceeding on October 8, 2003,[12] WorldCom's counsel explained that this 60-day period runs on October 25, 2003. Its counsel also

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[8] *Id.* at 21.

[9] *Securities and Exchange Commission v. WorldCom, Inc.*, Civ. No. 02-CV-4963 (JSR) (S.D.N.Y.)

[10] The report referred to is "Restoring Trust."

[11] The Corporate Monitor, Richard C. Breeden, is the author of "Restoring Trust."

[12] The letter appears as Appendix A to this decision.

stated that “WorldCom has no plans to file any such motion in Judge Rakoff’s court and it fully intends to adopt and implement all of the recommendations made by Mr. Breeden.” WorldCom’s counsel later confirmed that it made no such motion.

The “Restoring Trust” report contains 78 individual recommendations. These cover the selection of directors; qualification, conflicts and independence standards for board members; the functioning of the board and its committees; establishment of the position of non-executive chairman; specific limits on compensation practices; equity compensation programs; accounting and disclosure issues; ethics and legal compliance programs; and other areas. According to the report, the recommendations shift the balance of power in governance of the company to the shareholders, while still allowing management to have flexibility to meet business challenges.

In summary, in accordance with Judge Rakoff’s order, the foregoing 78 recommendations will be enforceable by the District Court against WorldCom, and WorldCom has declined to ask the Court to waive any of the recommendations.

3. WorldCom’s Reorganization

Under the terms of the reorganization, WorldCom will continue to operate its long distance business in California and elsewhere without interruption. None of its California rates or terms of service will change, and WorldCom represented that it has not discontinued or diminished its service to its utility customers despite its bankruptcy filing.

The proposed Plan will reorganize the capital structure of WorldCom. The new company will change its name to MCI, Inc. (MCI), which will continue to be a widely held public corporation regulated by the SEC. While currently there are eight subsidiaries of WorldCom providing service in California as competitive local exchange carriers, only one firm, MCImetro Access Transmission Services (MCImetro) will remain after the reorganization. All customers of the dissolving subsidiaries will nonetheless continue to receive service under the same rates, terms and conditions they currently enjoy pursuant to existing tariffs unless those tariffs are changed in accordance with normal Commission policy. These customers will also receive notice of the organizational changes, and the Commission will review any tariff changes.

The services, rates, terms and conditions of service provided to MCI and MCImetro customers will remain subject to the jurisdiction of this Commission to the same extent as they were prior to the bankruptcy. MCI and its subsidiaries will continue to file tariffs, notices, and reports with state commissions, as appropriate, regarding all of their intrastate services.

The Bankruptcy Court issued its Order confirming the Plan of Reorganization on October 31, 2003.[13]

4. The Application

With its application, WorldCom asks us to exempt the restructuring and related intra-corporate transactions undertaken to consummate WorldCom's Chapter 11 Plan from prior Commission approval under Pub. Util. Code §§ 851 and 854. It explains that the reorganization will have direct and indirect effects on the legal structure of the Company's California public utility subsidiaries that

[13] *Order Confirming Debtors' Modified Second Amended Joint Plan of Reorganization under Chapter 11 of the Bankruptcy Code,* dated October 31, 2003, *In re WorldCom, Inc.,* Case No. 02-13533 (AJG) (Bkrtcy. S.D.N.Y.).

might, on their face, be subject to the approval requirements of §§ 851 and 854, but asks us to exempt it from obtaining such approval pursuant to § 853(b).

Section 853(b) provides that "The commission may from time to time by order or rule . . . exempt any public utility . . . from this article[14] if it finds that the application thereof with respect to the public utility . . . is not necessary in the public interest." Thus, we have the authority to exempt a utility from §§ 851 and 854 if we find the public interest does not require that we apply them.

Discussion

The Commission grants exemptions under § 853(b) only in extraordinary situations.[15] We have recently granted § 853(b) exemptions in cases unlike this one, and denied such exemption in a case similar to this one. In D.02-10-008, we granted Pacific Gas and Electric Company (PG&E) an exemption from filing a § 851 application every time one of its customers wanted to buy its electric meter on the ground that it would be unduly cumbersome and uneconomic to require individual filings by utilities for each individual meter sale. We found that imposing such a requirement would not serve the public interest.[16]

In D.02-01-055, we exempted PG&E from obtaining § 851 approval where it had failed to obtain such approval prior to selling utility assets to individual customers. We found PG&E's situation to be extraordinary because the sales

[14] Article 6, Transfer or Encumbrance of Utility Property, contains both §§ 851 and 854.

[15] D.02-01-055, 2002 Cal. PUC LEXIS 2, at *7.

[16] 2002 Cal. PUC LEXIS 636, at *7.

were otherwise in the public interest and because to undo or void the 12-year-old sales would harm customers.[17]

However, in a recent case similar to this one, we denied a § 853(b) exemption to enable Metromedia Fiber Network Services to emerge from bankruptcy, and instead approved the application under § 854.[18] There, as here, the company declared that the transaction was integral to a plan of reorganization that would enable it to emerge from bankruptcy. The Commission's Executive Director decided that "given the complexity of the proposed transaction, the public interest [was] best served through Commission review of the details of th[e] application."[19]

By the same token, the Commission's Executive Director signed the decision pursuant to delegated authority, and the full Commission did not review and approve the transaction. Because the Executive Director may have lacked delegated authority to invoke § 853(b) and exempt the transaction from § 854, the result was appropriate in that case.

Whatever the limits of the Executive Director's delegated authority, there is no question that § 853(b) grants the full Commission the power to exempt a transaction from the requirements of §§ 851 and 854. For the following reasons, we believe exemption is warranted in this proceeding.

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[17] 2002 Cal. PUC LEXIS 2, at *7-*8.

[18] D.03-08-079, 2003 Cal. PUC LEXIS 418, at *1.

[19] *Id.* at *2.

First, and most importantly, the transaction changes no rates or terms of service for existing customers. We retain full authority to review any such changes in the future.

Second, the Company is taking extraordinary steps to change the practices of the past. The "Restoring Trust" report, which will be fully enforceable by the United States District Court, goes well beyond many legal requirements imposed on corporations by the SEC and other regulators. Not only has WorldCom agreed to be bound by the recommendations in the report, but the Court will also retain jurisdiction to enforce those recommendations:

> [T]he Court, at the parties' express request, will continue to retain jurisdiction for however long it takes to make certain that these new controls and procedures are fully implemented and secured.[20]

Despite the fact that it is in bankruptcy proceedings, WorldCom has not disputed the jurisdiction of the District Court to enforce the report's recommendations, and Judge Rakoff retains such jurisdiction.[21]

Third, evidence that the transaction is in the public interest is strong. It is appropriate to allow a viable competitor in the California long distance market to emerge from bankruptcy proceedings so long as there are mechanisms in place to prevent the recurrence of the prior misdeeds. We believe the record before us demonstrates that such protections are in place.

Fourth, the Commission and the commissions of several other states have stipulated in the bankruptcy proceeding to use their best efforts to act on WorldCom's state applications no later than November 19, 2003. In return, we

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[20] Restoring Trust, Exh. A, at 18.

[21] PHC Transcript at 12.

and the other commissions received written assurances from WorldCom that WorldCom would not press claims it had earlier raised that the regulatory laws of approximately 31 state public utilities commissions are preempted pursuant to Section 1123 of the Bankruptcy Code, and that state regulatory review of WorldCom's reorganization is preempted by Section 525 of the Bankruptcy Code. While we disagree that any such preemption claims would have had validity,[22] WorldCom's voluntary agreement not to raise such claims in the bankruptcy proceeding if we resolved this case quickly ensures that the Commission will not have to fight this jurisdictional issue in the WorldCom bankruptcy.

For the foregoing reasons, so long as the following conditions are met, we find that there is an extraordinary situation that warrants the use of the Commission's authority under § 853(b) to exempt the reorganization plan from §§ 851 and 854 review. WorldCom (or its successor(s) after the reorganization is approved) may not change rates, conditions or terms of service for its California customers. WorldCom and its successors must come to the Commission for such relief. The reorganization of WorldCom proposed here shall not have any impact on the Commission's jurisdiction over WorldCom or its successors.

All this decision does is allow WorldCom to obtain Bankruptcy Court approval of its reorganization Plan and to represent to that Court that this Commission need not approve the reorganization in order for the Bankruptcy Court to do so.

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[22] We disagree with WorldCom that we lack jurisdiction to review its reorganization plans, and waive §§ 851 and 854 review for the reasons set forth in text rather than out of any concern that we lack jurisdiction over the company.

Reduction of Comment Period

WorldCom and Greenlining by stipulation filed and served on September 24, 2003 agreed to reduce the 30 day waiting period required by Section 311(g)(1) of the Public Utilities Code of the Commission's Rules of Practice and Procedure to five days and the reply comment period to three days. Comments were filed on November 7, 2003. No party filed reply comments.

WorldCom opposes our proposal to require as a condition of our decision that the "Restoring Trust" recommendations be enforceable by this Commission, raising jurisdictional objections. While we do not agree with WorldCom's jurisdictional concerns, its objection raises thorny legal issues that we do not believe we need to resolve here in order to approve the application. We believe it sufficient that these recommendations are enforceable by the District Court. Thus, we remove the condition that the "Restoring Trust" recommendations be enforceable in this forum. WorldCom also suggests a few housekeeping changes to the decision, which we make.

Greenlining supports the draft decision, noting that it has entered into an agreement with WorldCom that "demonstrates MCI's [the former WorldCom's] intent to be a corporate leader in supplier diversity, workforce diversity, Board of Directors diversity and philanthropy."[23] The agreement consists of a five-year commitment commencing as soon as WorldCom emerges from bankruptcy. The company has agreed to:

- Establish a goal of awarding at least 25% of all vendor contracts specifically to minority-owned businesses by the end of the five-year term of this agreement;

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[23] Greenlining Comments at 2.

- Endeavor to ensure that all levels of its workforce reflect the racial, ethnic and gender diversity of the adult workforce nationwide, including the top 50, top 100 and, if possible, the top 8 executives;
- Fill at least 50% of available Board positions with minority Board representatives;
- Make a good faith effort of striving to be placed in the top ranks of companies for their support of and relationship with minorities, as rated by independent organizations, such as Fortune Magazine and similar surveys; and
- Commit to a minimum of $15 million in philanthropy over five years intended to benefit racial and ethnic minority groups, including low income and underserved communities in California.

MCI has also committed to creating a Minority Consumer Council and to meeting with Greenlining two times a year, with the CEO attending at least one of these meetings.

Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Sarah R. Thomas is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. The recommendations in the report entitled “Restoring Trust” will be enforceable against WorldCom and its successors by the District Court for the Southern District of New York. The Court will retain jurisdiction for however long it takes to make certain that the new controls and procedures recommended in the report are fully implemented and secured in the future.

2. WorldCom did not ask the District Court to exempt it from any of the recommendations in the “Restoring Trust” report.

3. The “Restoring Trust” report contains 78 individual recommendations. These cover the selection of directors; qualification, conflicts and independence standards for board members; the functioning of the board and its committees; establishment of the position of non-executive chairman; specific limits on compensation practices; equity compensation programs; accounting and disclosure issues; ethics and legal compliance programs; and other areas.

4. The “Restoring Trust” report’s recommendations go beyond many legal requirements imposed on corporations by the SEC and other regulators.

5. The reorganization will not change rates, terms or conditions of service for WorldCom’s California customers.

6. The Commission and the commissions of several other states have stipulated in the bankruptcy proceeding to use their best efforts to act on WorldCom’s state applications no later than November 19, 2003. In return, we and the other commissions received written assurances from WorldCom that WorldCom would not press claims it had earlier raised that the regulatory laws of approximately 31 state public utilities commissions are preempted pursuant to Section 1123 of the Bankruptcy Code, and that state regulatory review of WorldCom’s reorganization is preempted by Section 525 of the Bankruptcy Code.

7. WorldCom has not disputed the jurisdiction of the District Court to enforce the “Restoring Trust” report’s recommendations.

Conclusions of Law

1. Pursuant to § 853(b), this Commission may exempt WorldCom from §§ 851 and 854 if we find that the application thereof with respect to WorldCom’s Plan is not necessary in the public interest. The Commission grants such exemptions only in extraordinary situations.

2. Application of §§ 851 and 854 to the Plan is not necessary in the public interest because the transaction changes no rates or terms of service for existing customers; the "Restoring Trust" report will be enforceable by the District Court; it is appropriate to allow a competitor in California's long distance market to emerge from bankruptcy so long as proper reforms are in place; and the Commission stipulated to process this application quickly to avoid a jurisdictional challenge by WorldCom.

3. This decision is subject to the following conditions:

a. WorldCom may not change rates, conditions or terms of service for its California customers as a consequence of this decision.

b. The reorganization of WorldCom proposed here shall not have any impact on the Commission's jurisdiction over WorldCom or its successors.

4. We should exempt the Plan from Commission approval pursuant to § 853(b) subject to the foregoing conditions.

O R D E R

IT IS ORDERED that:

1. This decision grants the application of WorldCom, Inc. (WorldCom) for an order pursuant to Pub. Util. Code § 853(b) exempting the restructuring and certain related intra-corporate transactions undertaken to consummate WorldCom's Plan of Reorganization under Chapter 11 of the Federal Bankruptcy Code from prior Commission approval under §§ 851 and 854.

2. This decision shall be subject to the following conditions:

a. WorldCom may not change rates, conditions or terms of service for its California customers as a consequence of this decision.

b. The reorganization of WorldCom proposed here shall not have any impact on the Commission's jurisdiction over WorldCom or its successors.

3. This proceeding is closed.

This order is effective today.

Dated November 13, 2003, at San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
SUSAN P. KENNEDY
Commissioners

Commissioner Geoffrey F. Brown, being necessarily absent, did not participate.

[Thomas Appendix A in A0308016]